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Debt situation of the developing countries as at mid-1997

Report of the Secretary-General

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* A/52/150 and Corr.1.

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I. Introduction

1. The General Assembly, concerned about the severe impact that the debt crisis was having on development and international economic stability, intensified its monitoring of the external debt problem of developing countries in 1986. Since then, the Assembly has contributed to the evolving international consensus over the strategies necessary to reduce the debt overhang of heavily indebted developing countries through its annual discussions and resolutions on the matter.

2. In the past few years, a new debt relief initiative was prepared by the World Bank and the International Monetary Fund (IMF) for a group of heavily indebted poor countries, many of which are in Africa. It has been endorsed by the Interim Committee of the Fund and the Development Committee of the Bank, as well as by the General Assembly, and represents a potentially important advance in the debt strategy. It embodies the principle, long sought in international deliberations, of a durable solution to the debt crisis based on equitable burden-sharing among all creditors, including multilateral institutions. Putting the Heavily Indebted Poor Countries Debt Initiative into practice, however, will require a high degree of international commitment to implementing debt-relief policies. It deserves full implementation in a timely and flexible manner in all the countries that warrant the high degree of relief that it entails.

3. The present report was prepared pursuant to General Assembly resolution 51/164 of 16 December 1996. It contains information on implementation thus far of the Initiative and on other dimensions of the debt situation of developing countries and policy measures to address them.[1] As with previous reports in this series, it was prepared in consultation with IMF, the World Bank and the United Nations Conference on Trade and Development.[2] The views expressed herein, however, are those of the United Nations Secretariat.

II. Recent trends in external debt

4. The external debt of net-debtor developing countries exceeded $1.8 trillion at the end of 1996, having risen by an estimated $110 billion during the year, or 6.4 per cent (see figure 1). About 45 per cent of this was owed by countries deemed to be severely indebted, (see table).[3]

5. While net borrowing raised external debt moderately in 1996 in Africa and Latin America (with a growth of 4 per cent and 3 per cent, respectively), the increase was a strong 10 per cent in Asia. Because the relative size of these increases has persisted for a number of years, Asia's share of total debt rose from 33 per cent to 46 per cent during the last decade. By the same token, Latin America's share dropped from 44 per cent to 36 per cent.[4] Africa's share also dropped in the same period, from 23 per cent to 18 per cent of the total, reflecting the continent's limited capacity to borrow new funds in the light of its still substantial debt overhang.

6. Lending by private creditors was once again the fastest growing component of long-term debt last year, rising nearly 12 per cent. This followed a temporary slowdown in 1995, which was largely a consequence of the private capital flight and official rescue packages for Mexico and Argentina. The quick return of private flows to those two countries, however, is particularly noteworthy. The overall growth of private lending was strongest in Asia (14 per cent); it grew 11 per cent in Latin America, while Africa continued to have more limited access to private capital (with a 7 per cent growth in 1996, mainly to South Africa). The share of private creditors in Africa's long-term debt remains a mere 25 per cent, compared to over 60 per cent in Latin America and 45 per cent in Asia (see figure 2).

7. Indeed, one source of the difficulty in resolving the debt situation of many African countries is the high share of debt owed to multilateral creditors, which measured 31 per cent in 1996 (see figure 2). The lending that created that debt was partly to support structural adjustment, but mainly for long-term social and economic investment. When economic circumstances required deep restructuring of the debt, however, the multilateral debt had to be excluded, limiting the degree of relief possible. This is one reason that the Heavily Indebted Poor Countries Debt Initiative is potentially so important.

8. In 1996, for the first time since the onset of the debt crisis in the early 1980s, the outstanding stock of official debt declined. The drop was largely the consequence of the exceptional official rescue packages for Mexico and Argentina, which made the 1995 value rise unusually and then reduced the 1996 one, owing to the pre-payment of some of that debt through refinancing in private markets. At the same time, however, total disbursements less repayments of concessional loans fell almost to zero, as larger net disbursements by multilateral creditors were offset by falling net bilateral flows.

9. Changes in the level of debt are hard to interpret. In normal circumstances, growing developing countries should see their external debt rising, reflecting foreign borrowing to supplement domestic resources for investment.

Difficulties arise when the borrowing is excessive. It is thus common practice in evaluating the capacity of countries to carry a given debt burden, to compare the growth of debt with the growth of exports of goods and services (which provide the foreign exchange for debt servicing) and gross national product (GNP), which is the broadest measure of income of the nation. In addition to tracing trends in the ratio of debt to exports and debt to GNP, analysts also typically calculate the ratio to exports of debt servicing (that is to say, interest plus principal payments).

10. On the basis of these three indicators, the overall debt situation of net-debtor developing countries continued to improve in 1996. Both the debt-to-exports ratio and the debt-to-GNP ratio declined to their lowest levels since the onset of the debt crisis.[5] The faster growth of output and export earnings that many developing countries have begun to experience mainly accounts for this, although some debt forgiveness in Africa also served to hold down the ratios in that region.

11. The regional debt-servicing ratios showed a more divergent pattern, which explains why the overall debt-service ratio did not fall in 1996. As may be seen in figure 3, in contrast to Africa and Asia, the debt-service ratio rose significantly in Latin America in 1996; but this was a temporary phenomenon, largely owing to the exceptional $7.5 billion principal pre-payment by Mexico to its official creditors as part of the refinancing of its 1995 package, as noted above.[6]

12. The debt-servicing trend in Africa, which has improved in recent years, nevertheless remains difficult. In the 1980s, the debt-servicing ratio of Africa was significantly below that of the net-debtor developing countries. During most of the 1990s, however, it was higher than the average of all countries. As may be seen in figure 3, Africa's ratio did fall below the average in 1995 and 1996, as export earnings growth was unusually strong in those years. However, export earnings are forecast to grow more slowly in 1997, and the debt-servicing ratio is likely to rise.[7] Moreover, the African debt-servicing ratio would have been higher if all debt-servicing due had been paid; continued accumulation of arrears shows that not to have been the case.[8]

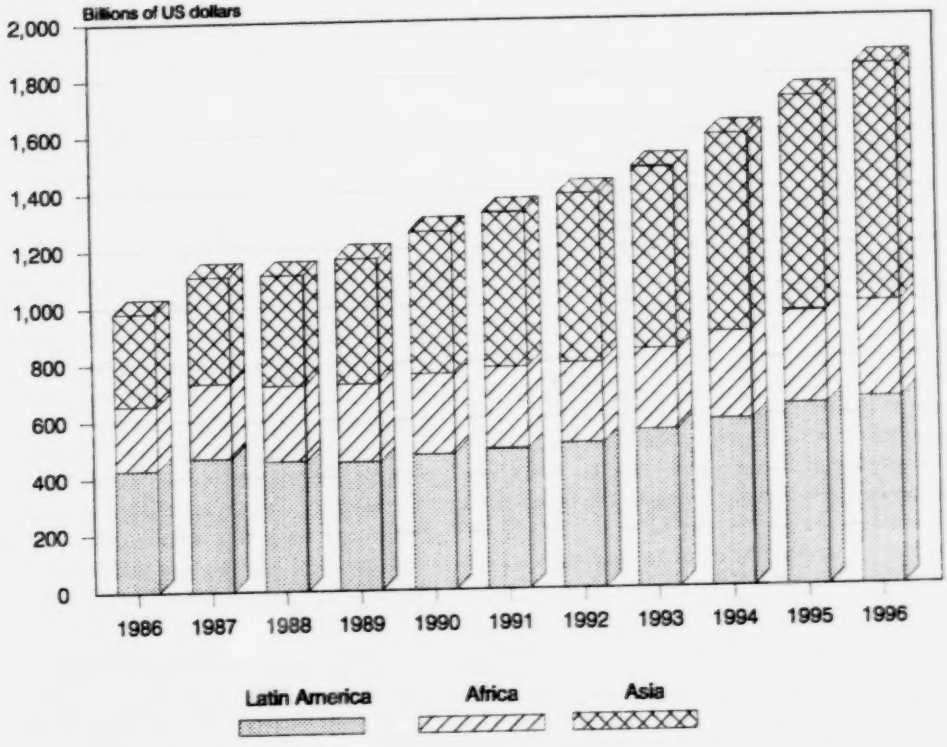
13. While aggregated data, such as have been discussed here, give one perspective on the debt situation of developing countries, the aggregates encompass a broad range of individual country situations. In order to get a fuller picture, examination of debt indicators at the country level is necessary (see the list of developing countries classified by the World Bank as "severely indebted" in the table). In 1997, the World Bank listed 51 developing countries as severely indebted , that is, as having either a ratio of the present value of debt service to GNP of over 80 per cent, or a ratio of the present value of debt service to exports of over 220 per cent, each ratio averaged over the three years from 1993 to 1995.[9] The World Bank's 1997 list was as long as its 1996 list.

14. As has long been the case, the composition of the list of severely indebted countries is notable in at least two respects. Firstly, 13 of the 51 countries included are middle-income countries, reminding us that debt vulnerability is not an exclusive feature of the poorest countries. Moreover, although Africa remains by far the most heavily represented region, 19 countries are from other regions, reaffirming the broader scope of the problem.

15. But Africa does remain a central concern in the realm of international debt policy, especially sub-Saharan Africa. The debt of Nigeria and 19 smaller countries exceeds their GNP. Moreover, accumulated arrears on principal and interest on long-term debt accounted for 28 per cent of the grouping's total debt at the end of 1996. Arrears accounted for one third of the total debt of the group of least developed countries.[10] Many of the countries accumulating arrears are experiencing civil war and strife, while others are recording stagnant growth of output and exports. For all the countries with debt difficulties, the debt overhang discourages investment and puts additional strain on the implementation of structural adjustment and reform.

16. The indicators underlying the World Bank's list are, in any event, not intended to be fully comprehensive measures of the debt situation. One aspect, among others, that is not captured by the indicators is the impact of domestic fiscal constraints on a country's debt-servicing capacity. In view of their limited focus, such indicators should therefore be used only as part of a broader sustainability analysis at the country level, which is indeed the approach increasingly being taken in practice in consideration of individual country debt relief needs.

Figure 1. Foreign debt of net debtor developing countries, 1986-1996

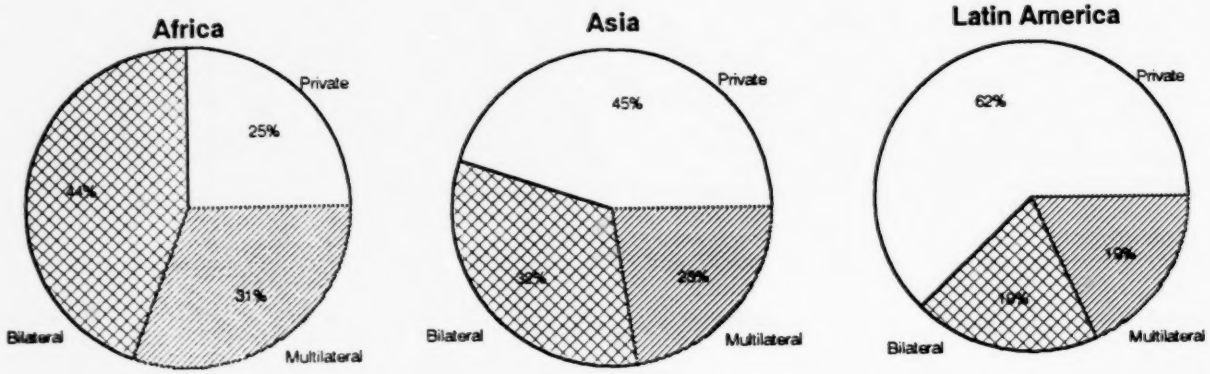


Source:

United Nations Department of Economic and Social Affairs, based on IMF, Organisation for Economic Cooperation and Development (OECD) and World Bank data.

Figure 2. Composition of long-term debt by region, 1996

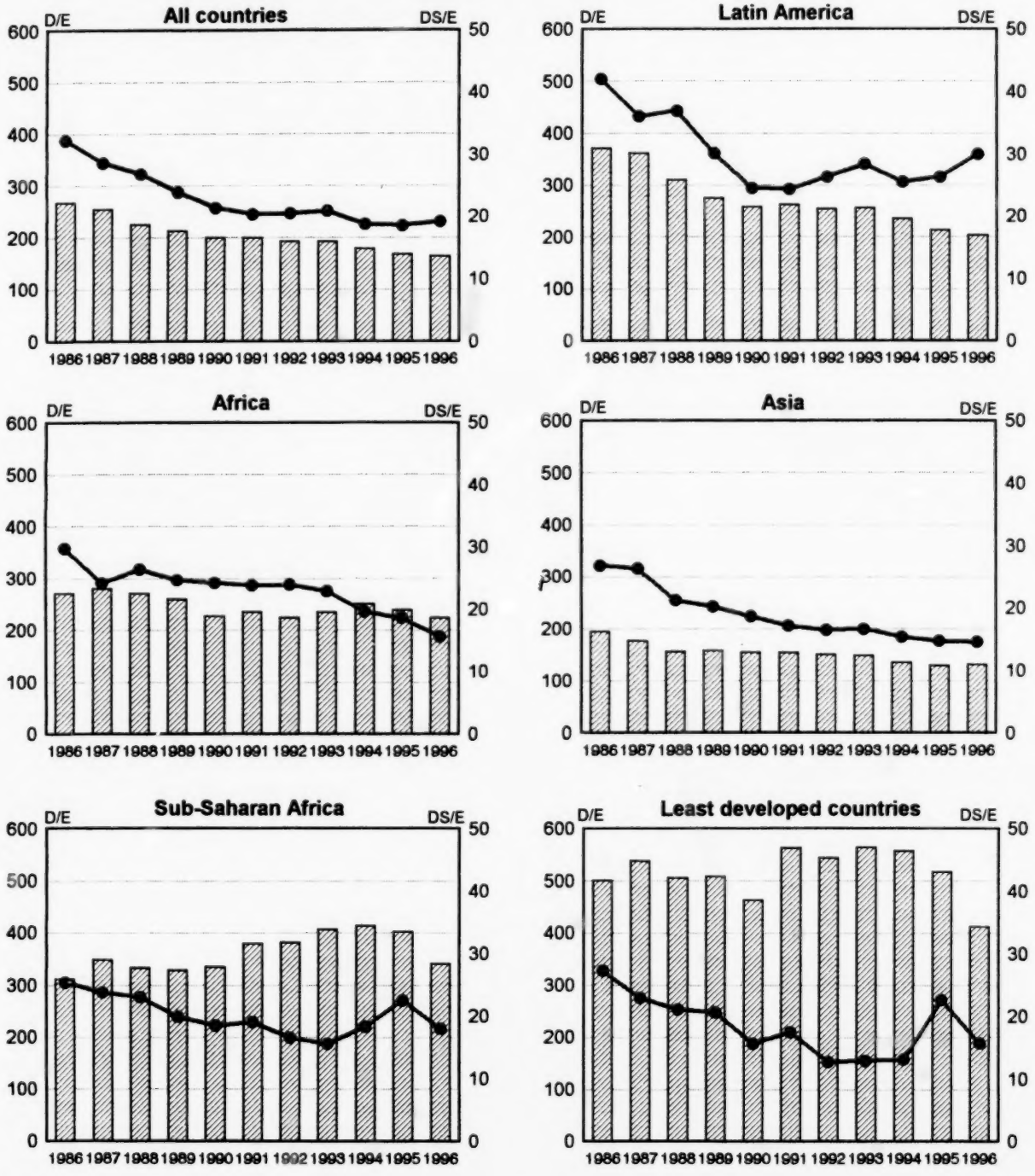
(Percentage)



Source:

United Nations Department of Economic and Social Affairs, based on IMF, OECD and World Bank data.

Figure 3. Selected debt indicators for net debtor developing countries,1986-1996



Source:

United Nations Department of Economic and Social Affairs, based on IMF, OECD and World Bank data.

Ratio of external debt to exports (D/E)
Ratio of debt service to exports (DS/E)

Developing countries classified as severely indebted by the World Bank[a]

Low income countries[b]	*Middle-income countries*[b]
Angola	Argentina
Burundi	Bolivia
Cambodia	Brazil
Cameroon	Ecuador
Central African Republic	Gabon
Congo	Jamaica
Côte d'Ivoire	Jordan
Equatorial Guinea	Mexico
Ethiopia	Panama
Ghana	Peru
Guinea	Syrian Arab Republic
Guinea-Bissau	
Guyana	Cuba[c]
Honduras	Iraq[c]
Kenya	
Liberia	
Madagascar	
Malawi	
Mali	
Mauritania	
Mozambique	
Myanmar	
Nicaragua	
Niger	
Nigeria	
Rwanda	
Sao Tome and Principe	
Sierra Leone	
Somalia	
Sudan	
Togo	
Uganda	
United Republic of Tanzania	
Viet Nam	
Yemen	
Zaire	
Zambia	
Afghanistan[c]	

[a] Countries in which the ratio of the present value of debt servicing to exports is above 220 per cent or the ratio of the present value of debt servicing to GNP is above 80 per cent.

[b] Countries are classified as low-income if their 1995 GNP per capita is $765 or less and middle-income if their 1995 GNP per capita is more than $765 but less that $9,385.

[c] Countries not reporting to the World Bank's debtor reporting system.

Source:

World Bank, *Global Development Finance, 1997*, vol. 1 (Washington, D.C., March 1997), pp. 61-62.

III. The international debt strategy: an update

17. The international strategy for assisting countries faced with severe debt burdens has included two main elements: (a) the adoption by debtor countries of macroeconomic stabilization and economic reform programmes supported by multilateral financial institutions, usually with new financing; and (b) debt restructuring involving some combination of rescheduling, partial cancellation of debt-service obligations and reduction of the stock of debt. Debt relief, in particular that accorded by official creditors, is normally extended *pari passu* with evidence of strengthened macroeconomic policies.[11] Over the past decade, the debt strategy has evolved towards increasing the degree of concessionality of external assistance to low-income countries, as the severity of the debt overhang of such countries was increasingly recognized. The main operations under the international debt strategy during 1996 and the first half of 1997 are reported below

A. Bilateral official creditors

18. The servicing of bilateral official debt is normally restructured in the framework of the Paris Club, where creditor Governments agree to offer a common set of terms for relief. The debtor Government then negotiates a set of implementing bilateral agreements with individual creditors. To ensure equitable burden sharing among the various categories of creditors, Paris Club agreements include a comparability clause, under which the rescheduling country pledges to seek at least comparable debt relief from commercial bank and non-Paris Club bilateral creditors.

19. In the early 1980s, Paris Club reschedulings were provided to low-income countries on the same terms as to middle-income countries, that is to say, with payments deferred and spread over relatively short periods (up to 10 years), including a grace period on principal payments, and with market interest rates charged on outstanding balances. However, as new official credits were extended in this period, and as unpaid interest obligations were partly capitalized in some cases, the stock of debt typically continued to increase.

20. By the late 1980s, it became clear that this approach to the debt problem was not working for many debtors. Their problem was not one of liquidity (temporary shortage of cash), but one of solvency. It was simply impossible for each of the countries to service all of its debt in full. Consequently, in June 1988, at a summit meeting in Toronto of the seven major industrialized countries, the major Paris Club creditors agreed to reschedule debt servicing of a number of low-income countries on concessional "Toronto terms". These terms entailed a menu of options from which the creditors would choose, aimed at reducing the present value of the rescheduled debt service by up to one third. Twenty countries benefited from Toronto terms, rescheduling almost $6 billion of debt.

21. While a group of lower middle-income countries was accorded easier debt-rescheduling under the Houston terms, the next major improvement in debt relief was offered to Egypt and Poland in the wake of the major political upheavals in Central and Eastern Europe and the Middle East. The difficult economic situation of many low-income debtors continued, however, and subsequently led to the adoption in December 1991 of the London terms by the Paris Club creditors. These terms increased the level of debt relief on eligible debt servicing to 50 per cent.[12] Agreements were signed with 23 countries under these terms, restructuring over $9 billion of debt.[13]

22. The maximum level of concessionality for low-income country debt relief was raised again in December 1994 to two thirds of eligible debt servicing under the new Naples terms. Creditors also agreed to consider a restructuring of the stock of eligible debt for countries that had established a satisfactory track record of macroeconomic policy adjustment and debt service payments for at least three years. Such stock-of-debt operations were intended to allow debtors to exit from the rescheduling process; that is to say, they were to be able to service future debt obligations without additional relief. Moreover, Naples terms allowed for the rescheduling of previously rescheduled debt, in order to "top up" the amount of concessionality provided earlier to the two-thirds level agreed under the Naples terms for the lowest-income countries.[14]

23. These progressively more concessional Paris Club terms, it should be noted, have not applied to all the debt of the debtor country, nor even to all the debt owed to the Paris Club Governments. Neither short-term debt nor debt contracted after each country's "cut-off date" is included in eligible Paris Club debt. The cut-off date is set the first time a debtor comes to the Club for a rescheduling and is usually left unchanged in following reschedulings. For Governments that have to come to the Paris Club for successive restructuring over many years, this can significantly limit the share of outstanding debt that is eligible for treatment. Moreover, concessional debt that originated in official development assistance loans cannot be reduced under the Paris Club, but is instead rescheduled over a long period

(normally 40 years, with 16 years of grace, and interest rates at least as concessional as the original rates). Creditor Governments may, however, choose to write off their outstanding official development assistance debt on a bilateral basis.

Recent agreements

24. Between January 1996 and June 1997, 19 debtor countries signed agreements with the Paris Club.[15] Out of those, 16 countries obtained Naples terms. With the exception of Honduras and Guinea, which obtained a 50 per cent reduction, the other 14 received a two-thirds reduction in debt servicing. Uganda and Bolivia obtained debt stock reductions in 1995, and, in the past 18 months, Mali, Guyana, Burkina Faso and Benin have also obtained such reductions. Since their establishment, Naples terms have been granted to 23 countries in 25 agreements, for total debt restructuring of over $9 billion.

25. The Paris Club has thus increasingly concentrated on the problems of poor countries. Indeed, during the period under review, only a few middle-income countries rescheduled their debt with the Paris Club. Among them were Peru, in July 1996, which rescheduled $6.7 million of debt, and Jordan, in May 1997.

26. The Paris Club mechanism covers the bilateral official debt of most developing countries, but it does not apply to debt owed to non-Club creditors, mainly Arab oil-exporting countries and the Russian Federation (which assumed the claims of the former Soviet Union). Arrears on these credits tended to increase after the Soviet Union collapsed and the financial situation of Arab oil exporters weakened. These creditors have, however, taken several steps to grant relief to their debtors, including reschedulings, debt cancellations and tolerating the accumulation of arrears; but the lack of a formal framework for relief measures has impeded a consistent approach to treating the debt owed to these countries.

27. In this regard, an important step was taken when the Russian Federation reached an agreement with the Paris Club in June 1997 on principles for its accession to the Club as a creditor country. The debt owed to the Russian Federation by several developing countries is estimated to total about $140 billion, applying the exchange rate regime of the former Soviet Union. However, the dollar value of the debt could now be reduced between 30 and 80 per cent for a number of countries, including Angola, Ethiopia, Guinea, the Lao People's Democratic Republic and Mozambique. Meanwhile, the Russian Federation agreed to restructure Angola's $5 billion debt, cancelling $3.5 billion and rescheduling the remaining $1.5 billion with a 10-year grace period.

B. Private creditors

28. With the implementation in 1996 of agreements for Panama and Peru, restructuring $3.9 billion and $8 billion respectively, most middle-income debtors in debt crisis have now taken advantage of the main mechanism for the reduction of their debt to international commercial banks. Since its establishment in March 1989, the "Brady Plan" has been applied to 15 middle-income countries, eliminating 20 per cent of their commercial bank debt, equivalent to over $40 billion.[16] These operations offer creditor banks a menu of options, including the buy-back of outstanding loans at a discount or their conversion into securities involving either a reduction of principal or of debt service. These securities are normally collateralized with United States treasury bonds purchased using reserve funds or the proceeds of loans from the Bretton Woods institutions. One additional agreement was signed in May 1997 by Côte d'Ivoire to restructure $7.2 billion of its commercial bank debt ($2.6 billion in principal and $4.6 billion in past-due interest), which will reduce its total commercial bank debt by nearly 79 per cent in present value terms. Côte d'Ivoire was thus to become the second African country, after Nigeria, to issue "Brady bonds".

29. The Brady Plan was intended to contribute to the improvement of the debtors' creditworthiness, leading to a restoration of their access to private financial markets. Despite the considerable relief embodied in the Plan, the debt-servicing obligations on the remaining debt (now in the form of Brady bonds) were not low cost. Thus, in an important development in 1996, Mexico and the Philippines retired Brady bonds in exchange for uncollaterized long-term bonds that they had become able to issue in the international markets. The advantages of these operations consisted both in the release of the collateral attached to the Brady bonds and better terms on the new bonds. They represent, in essence, a pre-payment of Brady bonds at a discount, funded by new issues. In a similar operation, in June 1997, Brazil converted $2.25 billion of Brady bonds into 30-year global bonds, the largest such offering ever issued by an "emerging-market" country. Other countries, such as Argentina and Venezuela, are reportedly considering similar operations.

30. For the most part, low-income countries have made use of a different programme for restructuring their debt owed to international commercial banks, namely, buy-back operations funded by official creditors and donors, especially the World Bank through its Debt Reduction

Facility.[17] The latter is available only to low-income countries eligible to borrow from the International Development Association (IDA). Since its inception in 1989, 13 low-income countries have taken advantage of this Facility, cancelling $4.3 billion of their commercial bank debt.[16] Between January and December 1996, operations involved Ethiopia, Mauritania and Senegal, which bought back a total $356 million of debt at an average price of 9 cents per dollar.

IV. The Heavily Indebted Poor Countries Debt Initiative[18]

31. In spite of the progress achieved through strengthened economic policies and the above-mentioned debt relief mechanisms, the number of developing countries with an unsustainable debt situation has remained very large, as pointed out earlier. Part of the problem for some countries was that the servicing of multilateral debt could not be formally restructured, owing to the "preferred creditor" status accorded to multilateral institutions.[19] But for a substantial number of countries, servicing of multilateral debt had itself become a difficult burden. Thus, to address the debt problem of low-income countries in a more comprehensive way, the Bank and the Fund proposed at the April 1996 meetings of the Interim Committee and the Development Committee, a framework of action for a new initiative for the heavily indebted poor countries. A new grouping of countries was identified from which countries eligible for the Heavily Indebted Poor Countries Debt Initiative would be selected.[20] A programme of action for implementation of the Initiative was subsequently endorsed by the two Committees at their September 1996 meetings, opening the way for its implementation in 1997.

32. The goal of the Initiative is to help countries to reach a "sustainable" debt-servicing burden.[21] Eligibility is limited to countries that are granted access to the Fund's Enhanced Structural Adjustment Facility (ESAF), and that qualify for borrowing at the World Bank only from IDA. An extended track record of sound policy performance under IMF/World Bank-supported programmes is also required.

33. The programme of action for the implementation of the Initiative has two stages. The first stage is the Naples terms process. It entails a rescheduling of debt-servicing obligations to Paris Club countries (and others) on Naples terms. At the end of that period, the debtor may be accorded a stock-of-debt operation by the Paris Club (that is to say, up to two-thirds reduction of debt). At that point, a decision can be made on whether the second stage is needed. The Boards of IMF and the Bank decide whether Naples stock terms, together with at least comparable relief by other bilateral and commercial creditors, are sufficient to bring the country to a sustainable debt-service position, based on a sustainability analysis agreed with the country's authorities. This is called the decision point.

34. Eligibility criteria for stage two were initially defined as a need for additional relief in order to bring the debt-service-to-exports ratio down to the range of 20 to 25 per cent and the ratio of the present value of debt service to exports to 200 to 250 per cent. In April 1997, the Boards of the Bank and the Fund added new flexibility and endorsed an additional criterion: the ratio of the present value of debt service to fiscal revenue should be no more than 280 percent, provided two other criteria are also met at the decision point, namely, an exports-to-gross domestic product (GDP) ratio of at least 40 per cent and a minimum threshold of fiscal revenue to GDP of 20 per cent. The addition reflects the realization that some economies might be penalized by the exclusive use of the two external-sector benchmarks, without giving due consideration to the fiscal burden of external debt. It also opened eligibility to additional countries. Côte d'Ivoire was expected to be the first country to benefit from the inclusion of the fiscal criterion in the debt sustainability analysis.

35. A further refinement to the calculation of the needed debt reduction was the adoption of three-year averages (rather than one-year results) in the calculation of the export earnings figures. The intent was to obtain a more representative indicator of the country's export experience. Finally, a set of "vulnerability factors", such as the country's reserve position, the concentration and variability of its exports, the resource gap and the burden of private-sector debt, has to be taken into account on a case-by-case basis in determining eligibility for stage two.

36. In the event that stage two is found necessary, the country is asked to establish a second three-year track record under Bank/Fund-supported programmes. During the second stage, Paris Club creditors are to reduce debt-servicing obligations by up to 80 per cent – 13 percentage points beyond that accorded under Naples terms – on a case-by-case basis, subject to a satisfactory implementation of the adjustment programme. In addition, from the beginning of the second stage, donors and multilateral institutions may provide additional assistance in the form of grants or concessional loans which, in some cases, could be used for debt-service payments (in particular, for servicing multilateral debt).[22]

37. At the end of the second three-year period is the "completion point". Provided the country has met certain performance criteria, the stock of Paris Club and comparable debt is reduced by 80 per cent of its original face value. Multilateral institutions are committed to then reduce their claims as necessary so that the total debt falls to a sustainable level. Performance criteria include macroeconomic indicators, progress on key structural reforms and social reforms (for example, improving basic health care and education and reducing poverty).

38. The six-year performance period under the Initiative is to be implemented flexibly on a case-by-case basis, so that countries that have already established track records receive credit for them in the first stage. Countries with an extended record of strong performance are asked to pass through a shortened second stage. Access to the Initiative is to remain available to all potentially eligible countries launching IMF/World Bank-supported programmes before October 1998. A possible extension would then be considered.

39. The total cost of financing the additional debt relief envisaged under the programme of action was estimated by the staff of the Bank and the Fund to be in the range of $5.5 billion to $8.4 billion, although the above-mentioned refinements in the eligibility analysis have already pushed the estimates towards the upper end of the range. The World Bank established the HIPC Trust Fund in November 1996 to fund the reduction in debt and debt servicing of the multilateral development banks. It allocated $500 million from its surplus on non-concessional lending as an initial contribution. A further substantial allocation is expected from the 1997 surplus. However, bilateral contributions to the Trust Fund will be important to fully cover the participation of all multilateral development banks. In a parallel operation, IMF established the ESAF-HIPC Trust to finance special ESAF operations under the Initiative, with an initial transfer of SDR 180 million (about $250 million) from the ESAF Trust Reserve Account and additional transfers to follow. Nevertheless, in no sense are the total funds so far committed sufficient to meet the expected need.

40. In April 1997, Uganda became the first heavily indebted poor country to reach the "decision point". The Executive Boards of the Bank and Fund agreed on a package of debt relief that would reduce the present value of Uganda's debt by $340 million. In view of Uganda's strong track record, the Boards decided to credit Uganda for stage one and shorten the second stage to one year, scheduling the completion point for April 1998. The Bank's contribution, through IDA, amounts to $160 million. IDA agreed to advance $75 million in the form of IDA grants before that date. IMF will provide the equivalent of $70 million in present-value terms. The remaining relief will have to be shared by other multilateral and bilateral creditors.

41. Another half a dozen countries are expected to reach the decision point by the end of 1997, among them Bolivia, Burkina Faso, and Côte d'Ivoire. More will follow in 1998, but it is considered quite possible that only about half dozen countries will have reached the completion point by the end of the decade.

V. International policy conclusions

42. In sum, as measured by the standard debt indicators, the overall debt situation of the developing countries has continued to improve since it was last reviewed by the General Assembly in 1996. However, a very substantial number of developing countries – over 50 by World Bank accounting – remain in difficult debt situations. There is thus a continuing need for international monitoring of the debt crisis and development.

43. Even if many of the severely indebted developing countries are currently meeting their debt-servicing burdens, they are doing so at a high economic cost and with little room left for adjusting to potential adverse economic developments. Other severely indebted countries are simply not meeting all of their debt-servicing obligations and are either building up arrears or are renegotiating their debt-servicing requirements on an ongoing basis. One concern, in particular for low-income countries with very high debt indicators, is that capacity to meet even post-negotiation debt-servicing obligations depends in part on continuing receipt of substantial official development assistance, and such flows must seem less assured today as overall flows of aid are diminishing.[23]

44. The international strategy that has evolved since the 1980s for ameliorating the debt situation has helped many countries return to regular access to external financing, albeit with a significant debt overhang often remaining, leaving them especially vulnerable to changes in market sentiment. The international strategy has been less successful, however, in alleviating the debt situation of the poorest countries despite increasingly concessional treatments. The Heavily Indebted Poor Countries Debt Initiative is thus a most welcome addition to the international debt strategy.

45. The Initiative has nevertheless been received with a measure of scepticism by a number of developing countries. For example, the Conference of African Ministers of Finance at its sixth session, held at Addis Ababa on 2 April 1997, while expressing appreciation to the international

community, *inter alia*, for development of the Initiative, also called for the intensification of efforts to find a durable solution to Africa's debt problems. The Conference urged more flexibility in setting eligibility conditions for reforming African countries that are in the process of reform, sought shortened completion points for countries with strong performance records and appealed to non-Paris Club bilateral creditors to reduce Africa's debt to them, while committing themselves to continued domestic reform.

46. In other words, the Initiative has the most promising potential thus far for reaching a durable solution to the debt problem of the poorest and most heavily indebted developing countries. It would treat their outstanding debt in a comprehensive manner, while supporting their adjustment and reform efforts. Its full implementation could lift the debt burden as an obstacle to economic growth and enable Governments to focus more on long-term policies necessary to accelerate development. All of this, however, depends on how it is implemented.

47. The Initiative is a complex undertaking, requiring unprecedented coordination of a large number of creditors and the settlement of many substantive and technical details. Flexibility and timely action are important determinants of the success of the process. A welcome step in this regard was the quick addition in the spring of 1997 of fiscal indicators to the criteria for evaluating the degree of relief needed to reach debt sustainability and thus access to the process.

48. A willingness to consider further amendments to the conditions for eligibility as well as for actually awarding special assistance is warranted, as experience is gained in the review of country cases. One already contentious issue, in particular, is the length of time needed to demonstrate an appropriate track record of strengthened policy. There is certainly nothing in economic theory or policy practice that makes a six-year period an absolute benchmark for certifying sound policy-making in developed, developing or transition economies. In any case, the countries that are building their track records should not suffer in terms of net external cash flow for the long waiting period before their final stock-of-debt agreement is implemented.

49. It is now of paramount importance that the relatively limited funding thus far committed to the Initiative not become a constraint to its rapid implementation. Bilateral donors might be mobilized as countries reach the decision point on a case-by-case basis, but confidence that the process will result in the required debt relief would be bolstered by the presence of a larger pool of resources in the IMF and World Bank trust funds. In this regard, the proposal to sell some of the Fund's gold holdings and place a portion of the profits in the ESAF-HIPC Trust might now warrant further consideration. Whether through such a mechanism or direct allocations of budgetary expenditures by donors, the funds will need to be in place as increasing numbers of countries pass through the process.

50. Countries that begin the process are being told that at the end of an extended period of difficult adjustment measures they will still be in a parlous situation unless they receive a special degree of debt relief. It is essential that they indeed receive that relief.

51. Finally, beneficiaries of the Initiative and other heavily indebted developing countries will continue to require a supportive international economic environment, including improved conditions of access to markets for their exports, appropriate access to technology and private financing, an international monetary and financial system that is not vulnerable to excessive volatility and adequate official development assistance flows.[24]

Notes

[1] Several of the countries with economies in transition, from central-planning to market-based systems, have also experienced severe debt difficulties, and these have also been a concern of the international community. In recent years, the debt situation of most of these countries has improved markedly. The Russian Federation, in particular, arranged a final settlement of the debt obligations of the former USSR to commercial banks (1995) and to Governments (1996 and 1997). Hungary, which sustained a heavy debt-servicing burden while avoiding debt rescheduling, was able to repay $4 billion in outstanding debt after having had a period of substantial capital inflows (see *World Economic and Social Survey, 1997* (United Nations publication, Sales No. E.97.II.C.1), pp.53-54). Currently, only Bulgaria, among the transition economies, is classified as a heavily indebted country by the World Bank, as per the criteria in the table.

[2] While underlying country data in this report are those of the Bank and the Fund, country groupings shown are those of *World Economic and Social Survey 1997* (see introduction to the statistical annex of the *Survey*).

[3] This may be contrasted with the situation before the major mechanisms of the international debt strategy were put in place. The share of the debt of the countries judged to be severely indebted in 1988 was 57 per cent of the total.

[4] Nevertheless, the two countries with the largest debt are still Latin American (Mexico and Brazil), followed by two Asian countries (China and Indonesia).

[5] For details, see *World Economic and Social Survey, 1997*, table A.37.

[6] The rise in debt-servicing ratios in sub-Saharan Africa and in the least developed countries in 1995 reflected, *inter alia*, repayment of outstanding arrears by certain countries as their debt-restructuring agreements came into effect.

[7] Based on trade forecast in the *World Economic and Social Survey, 1997*, table A.19 (for a comparable forecast, albeit excluding Egypt and the Libyan Arab Jamahiriya from the African grouping, see IMF, *World Economic Outlook* (May 1997), tables A.25 and A.42.

[8] See *World Economic and Social Survey, 1997*, table A.36.

[9] The present value calculation aims to account for the effect of different borrowing terms from each creditor on the debtor's payment obligations over time. It is a meaningful way to compare the actual exposure of each creditor to a given debtor, although it is used in a somewhat different way in the table. The measure is obtained first by discounting the scheduled debt service to be paid to each creditor or multilateral institution at its relevant rate of interest on market-based loans. The present value of the country's total debt is then the sum of the present values of the debt servicing owed to each creditor. The present value of the debt is thus that amount of money which, if set aside today and lent at market terms, would generate a flow of funds over time equivalent to the scheduled debt-servicing flow. A key aspect of the measure is that the more concessional the interest rate on a loan, the smaller the annual interest payments over time and thus the smaller the present value of the loan (the less it is worth to the creditor). A key problem is that market interest rates – and thus the discount rates – change over time and the calculated present value is quite sensitive to changes in the discount rates (see World Bank, *Global Development Finance, 1997*, vol. 1 (Washington D.C., March 1997), p. 49). In other words, debt indicators based on present value measures of debt servicing are only rough guides to the severity of a country's debt situation.

[10] The least developed countries, as such are not usually accorded special treatment in international policy on external debt relief, as they are in the spheres of trade policy or official development assistance. However, 28 of the least developed countries are classified as severely indebted low-income countries (see table) and 29 were included in the initial grouping of potential recipients of treatment as heavily indebted poor countries. For a discussion of debt problems of the least developed countries, see UNCTAD, *The Least Developed Countries, 1997 Report*, forthcoming.

[11] For a summary of the major components of the international debt strategy, see the report of the Secretary-General on the developing country debt situation as of mid-1995 (A/50/379 and Corr.1), table 1.

[12] For more details, see World Bank, *World Debt Tables 1992/93*, vol. 1 (Washington, D.C., December 1992), pp. 75-78.

[13] See World Bank, *World Debt Tables 1991/92*, vol. 1, p. 62, for a summary of Toronto terms agreements; and *World Debt Tables, 1994/95*, vol. 1, p. 64, for a summary of London terms agreements.

[14] Under the Naples terms, countries with per capita incomes of more than $500 and a debt-to-exports ratio of less than 350 per cent, which would not qualify for the two-thirds debt stock reduction, could nevertheless receive a 50 per cent net reduction in the present value of treated debt.

[15] The following 14 countries signed agreements in 1996: Zambia, Honduras, Sierra Leone, Ghana, Mali, Guyana, Burkina Faso, Chad, Congo, Peru, Yemen, Benin, Mozambique and Niger. Five countries reached agreements in the first half of 1997: United Republic of Tanzania, Ethiopia, Guinea, Madagascar and Jordan.

[16] See World Bank, *Global Development Finance, 1997*, vol. 1, p. 79.

[17] The Debt Reduction Facility provides grants for use in buy-backs of commercial bank debt at deep discounts, using contributions from the net income of the Bank and from donors.

[18] This section draws extensively from A. Boote and K. Thugge, "Debt relief for low-income countries and the HIPC initiative", IMF working paper WP/97/24 (Washington, D.C., March 1997), as well as discussions with officials of IMF and the World Bank.

[19] Debtors commit themselves to service debt to these institutions before other obligations.

[20] Preliminary analysis produced an initial list of 41 countries, comprising all of the severely indebted low-income countries listed in the table, except Afghanistan, Cambodia and Malawi, plus Benin, Bolivia (a severely indebted middle-income country), Burkina Faso, Chad, the Lao People's Democratic Republic and Senegal.

[21] Sustainability is defined as the ability "to meet current and future extremal; debt-service obligations in full, without recourse to debt relief, rescheduling of debt or the accumulation of arrears, and without unduly compromising growth" (see Boote and Thugge, op. cit., p. 17).

[22] In borderline cases, the country would receive further flow rescheduling under the Naples terms, with the assurance of additional action at the completion point, if needed.

[23] See the report of the Secretary-General on finance for development, which addresses recent aid trends in more detail (to be issued).

[24] The requirements of an enabling environment for development were spelt out in more detail in the agreed conclusions of the high-level segment of the Economic and Social Council (to be issued in *Official Records of the General Assembly, Fifty-second Session, Supplement No. 3* (A/52/3/Rev.1) adopted at its substantive session of 1997.